



Amy G. Rabinowitz  
*Counsel*

March 22, 2004

Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station  
Boston, MA 02110

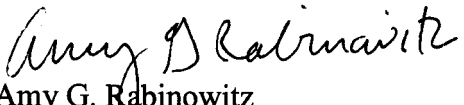
**Re: D.T.E. 03-124**

Dear Secretary Cottrell:

I am enclosing the supplemental response of Massachusetts Electric Company and Nantucket Electric Company to Information Request AG-MECO 1-4.

Thank you very much for your time and attention to this matter.

Very truly yours,

  
Amy G. Rabinowitz

cc: Service List

Massachusetts Electric Company  
Nantucket Electric Company  
Docket No. D.T.E. 03-124  
Supplemental Response to the Attorney General's First Set of Information Requests

Information Request AG-MECO 1-4

Request:

Please refer to the direct testimony of Ms. Burns at 11, line 15. Provide a copy of the rate settlement in its entirety. Indicate where in the settlement the recovery of standard offer service and default service costs are addressed.

Response:

Footnote 4 of Ms. Burns' testimony specifically relates to congestion costs incurred by the Company pursuant to the amendment of one of its wholesale Standard Offer Service contracts due to the implementation of Standard Market Design ("SMD"). In Ms. Burns' testimony, and in more detail in Mr. Hager's testimony, the Company explained the purpose of this amendment. The intent of footnote 4 of Ms. Burns' testimony is to state that the congestion costs incurred subsequent to the implementation of SMB qualify for treatment as both a reclassification of costs and as a new cost pursuant to a regulatory rule change.

The amounts identified in Exhibit MJH-7 tally the monthly accumulation of congestion costs under the contract amendment. The Company incurs these congestion costs as a result of serving Standard Offer Service load in the Southeastern Massachusetts ("SEMA") reliability zone.

The Department's August 20, 2003 letter order in D.T.E. 03-67 addressing this contract amendment is attached.

Prepared by or under the supervision of: Theresa M. Burns



THE COMMONWEALTH OF MASSACHUSETTS  
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION

DEPARTMENT OF  
TELECOMMUNICATIONS & ENERGY

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August 20, 2003

Amy G. Rabinowitz, Counsel  
Massachusetts Electric Company and  
Nantucket Electric Company  
25 Research Drive  
Westborough, MA 01582-0099

Re: Massachusetts Electric Company/Nantucket Electric Company, D.T.E. 03-67

Dear Ms. Rabinowitz:

Introduction

Massachusetts Electric Company and Nantucket Electric Company (together, "MECo" or "Company") filed a request with the Department of Telecommunications and Energy ("Department") for approval of an amendment to the Company's standard offer service supply contracts ("Original Contracts") with one of its current standard offer service suppliers that provides a portion of the standard offer service requirement for the former Eastern Edison Company ("EECo"). MECo also seeks recovery of the costs associated with the amendment. The amendment will not become effective unless the Company receives Department approval on or before August 20, 2003 to include these costs as part of the Company's standard service cost adjustment provisions (Petition at 4).

If approved by the Department, the Company estimates that the amendment would result in an increase of approximately \$3.2 million per year over the price that the Company pays under the Original Contracts and a bill increase of approximately twelve cents per month for a typical residential standard offer service customer using 500 kilowatt-hours ("KWH") of electricity per month (id. at 1). The Department docketed this matter as D.T.E. 03-67.

According to the Company, under the NEPOOL pricing scheme in existence when the Original Contracts were executed in 1998, costs to both the supplier and MECo were clearly defined. With the implementation of the Independent System Operator - New England's ("ISO-NE") standard market design ("SMD") and locational marginal pricing ("LMP") that went into effect on March 1, 2003, the Company and the supplier have different interpretations of their respective obligations under the Original Contracts (id. at 2). Under the supplier's interpretation, in reliance on language claimed unique to this supplier's agreement, the supplier would have the ability to deliver supply to any point in the NEPOOL system without incurring any additional congestion costs, thereby potentially leaving the Company and its customers to bear the incremental congestion cost burden. If the Original Contracts were construed such that the Company must bear congestion costs, MECo alleges that it would be unable to effectively mitigate its congestion cost expense (id.).

The amendment provides that the Company will pay an additional fee to the supplier (\$3.2 million annually over the amount that would be paid under the Original Contracts) on a fixed per-KWH basis, in exchange for the supplier's agreement to deliver standard offer service directly to the Company's load centers. The supplier will bear any congestion costs required to meet its delivery obligation (id. at 3). Pursuant to a notice issued by the Department, comments and reply comments were received by MECo and the Attorney General of the Commonwealth of Massachusetts ("Attorney General").

## II Summary of Comments

### A. Company

The Company alleges that the amendment is in the public interest for the following reasons. First, MECo argues that the amendment caps customer exposure to upside congestion risk because the fee charged is fixed on a per-KWH basis and cannot increase during the term of the Original Contracts (i.e., through February 28, 2005) (id. at 1). Second, MECo argues that the supplier can better mitigate congestion costs, and that the supplier has "agreed to the bear the congestion cost risk at a reasonable price." Finally, the Company argues that the amendment reduces litigation risk (id. at 1-2).

MECo accepts the Attorney General's argument that the Federal Energy Regulatory Commission ("FERC") has jurisdiction over the underlying agreements (MECo Comments at 1). However, the Company states that it has conditioned the effectiveness of its contract amendment on Department approval in order to avoid any jurisdictional conflicts (id. at 2). MECo argues that if it had not conditioned the amendment on Department approval, all the supplier would be required to do is file the amendment with FERC and that the Department

would then be pre-empted from disallowing the recovery of the costs that the Company incurs under the amendment (id.).

MECo argues that its proposal for cost recovery is consistent with the terms of the EEC0 restructuring settlement agreement (id.). MECo states that, at the time the Original Contracts were executed, the restructured wholesale power market was still under development and the agreements did not specifically contemplate SMD and its treatment of congestion costs (id.). The Company argues that it should not be denied recovery of costs reasonably incurred under a wholesale power supply contract because of fundamental changes in the operation of the wholesale power markets as a result of SMD (MECo Reply Comments at 1). In sum, the Department argues that the Department has adequate authority to (1) undertake a review of the amendment and approve it as an appropriate way to mitigate customers' potential exposure to congestion costs under the new SMD rules, and (2) to clarify that the resulting costs are recoverable in retail rates (id.).

B. Attorney General

The Attorney General argues that, because the Original Contracts are wholesale contracts involving the sale of power for resale in interstate commerce, FERC, and not the Department has jurisdiction over the proposed contract amendments (Attorney General Comments at 2). In addition, the Attorney General argues that the settlement approved by the Department in Eastern Edison Company/Montaup Electric Company, D.P.U./D.T.E. 97-105, at 8 (1999), exempts the Original Contracts from further Department review and approval under G.L. c. 164, § 94A because "the FERC's continuing jurisdiction with respect to these Standard Offer Agreements constitutes the alternative process which is in the public interest" (id. at 3). Therefore, the Attorney General argues that MECo should make a filing with FERC if it seeks an amendment to the Original Contracts (id. at 4).

The Attorney General also argues that MECo's request to recover additional standard offer service costs violates the terms of the EEC0 restructuring settlement agreement. Specifically, the Attorney General argues that the wholesale restructuring settlement agreement approved by the Department in Eastern Edison Company, D.P.U./D.T.E. 96-24 (1997) requires Montaup and its successors or assigns to provide EEC0 with standard offer service at specific prices adjusted only for a fuel index, and does not provide for the recovery of congestion costs from customers (Attorney General Comments at 4-5).

The Attorney General disputes the Company's contention that, absent Department approval, all the supplier has to do is file the amendment with FERC (Attorney General Reply Comments at 2). The Attorney General claims that MECo wrongly equates a vendor supply contract with a filed rate under the Federal Power Act. The Attorney General alleges that the "filed rate" in this case is not the Original Contracts that the Company seeks to amend, but rather the standard offer service charges set forth in the FERC-approved Montaup restructuring settlement agreement (*id.*). The Attorney General states that if it proceeds with the amendment, MECo must seek to modify its "filed rate" in a FERC proceeding (*id.*). The Attorney General argues that whether the operation of the wholesale market changed and caused the Company to incur additional costs and whether the incurrence these additional costs was foreseeable when the Original Contracts were entered into is a question of fact for a FERC hearing (*id.* at 2-3).

Finally, the Attorney General argues that, because the Department has not reviewed the Original Contracts pursuant to G.L. c. 164, § 94A, the Department must conduct a prudence review prior to the pass-through of any additional standard offer service costs. Even if the Company were to be found liable for congestion costs, the Attorney General argues that MECo must establish prior to the recovery of any additional costs from ratepayers that it was prudent to enter into standard offer service contracts that contain unique language not found in any of the Company's other standard offer service agreements (Attorney General Comments at 5).

### III Analysis and Findings

The manner in which ISO-NE's market rules treat transmission congestion costs changed significantly with the implementation of SMD on March 1, 2003. Congestion costs arise when ISO-NE is required to dispatch higher-priced, out-of-merit generating units than otherwise would be dispatched if there were no transmission constraints in the region. Prior to the implementation of SMD, ISO-NE operated a single region-wide spot market where the hourly energy clearing price ("ECP") was based on the bid price of the marginal generating unit that would have been dispatched if there were no transmission constraints. The above-market costs of the units dispatched out-of-merit were not recovered through the ECP; instead, ISO-NE allocated these costs to electricity consumers throughout New England, based on what the market rules refer to as "network load." Under a network load allocation, ISO-NE assigned costs to the transmission providers throughout New England, based on each provider's share of the overall regional load.

Pursuant to the market rules in effect under SMD, ISO-NE now operates eight spot markets, based on pre-specified load zones with each market producing an hourly LMP.<sup>1</sup> Unlike the pre-SMD energy clearing prices, zonal LMPs are based on the bid price of the

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In reality, ISO-NE operates hundreds of nodal spot markets. For the sake of simplicity, the Department assumes that the LMPs are equal for each node within a load zone.

marginal unit dispatched to serve load in that zone, regardless of whether the unit was dispatched out-of-merit because of transmission constraints. Congestion costs are no longer allocated to transmission providers based on network load – instead, they are included in the hourly LMPs for each zone.<sup>2</sup> The implementation of SMD changed the treatment of congestion costs in two important ways. Under SMD, congestion costs are (1) localized within load zones, rather than socialized throughout New England, and (2) treated as generation costs, rather than transmission costs. The Company argues that because ISO-NE treats congestion costs as generation-related under SMD, it should be allowed to recover these costs from its customers as a generation-related expense.

MECo has been treating congestion-related expenses as set forth in the proposed amendment since March 2003. The Company states that it has paid approximately \$1.2 million in congestion-related expenses to date pursuant to the amendment, compared to the amount that the supplier would have billed the Company absent the amendment (between \$4.6 million to \$6.4 million) (MECo Reply Comments at 3). In exchange for a fee charged on fixed on a per-KWH basis amounting to approximately twelve cents per month for the average residential customer, congestion cost exposure and litigation risk would be removed. As a result, MECo argues that the proposed amendment is a reasonable means to mitigate customers' potential exposure to congestion costs under the new SMD rules.

The above analysis assumes, however, that MECo, and not the supplier, would be required to bear congestion costs under the terms of both the Original Contracts and the EECe restructuring settlement agreement. An additional factual record is necessary to determine the exact nature of the congestion cost and litigation risks faced by MECo's ratepayers, and thus, whether the proposed amendment is in the public interest. However, it is premature for the Department to open an additional investigation. Both the Company and the Attorney General agree that FERC, and not the Department, has jurisdiction over any amendment to the Original Contracts. Under the terms of the settlement agreement approved in D.P.U./D.T.E. 97-105, at 8, the Department found that continued jurisdiction by FERC over the terms of the Original Contracts was in the public interest. In the event that FERC approves any amendments to the Original Contracts (or ultimately to the Company's filed rate), the Department would then

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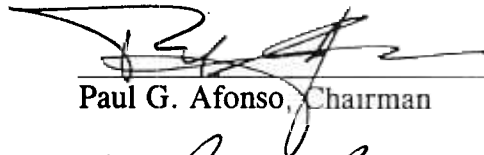
To the extent that a higher-priced unit is dispatched in a particular zone because of transmission constraints, the LMP for that zone would be higher than in other zones. The difference in zonal LMPs is, in effect, the congestion costs associated with the zone.

D.T.E. 03-67

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consider the ratemaking treatment of any costs incurred pursuant to the amendment. Accordingly, after due consideration, the Company's request for approval of an amendment to the Original Contracts is denied.

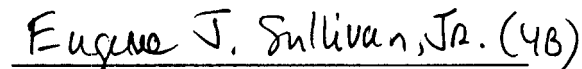
By Order of the Department.



Paul G. Afonso, Chairman

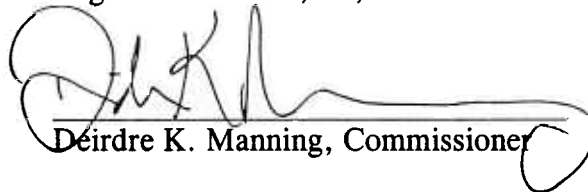


W. Robert Keating, Commissioner



Eugene J. Sullivan, Jr. (48)

Eugene J. Sullivan, Jr., Commissioner



Deirdre K. Manning, Commissioner

cc: Joseph W. Rogers, Assistant Attorney General  
Chief, Utilities Division